

MULTIMEDIA



UNIVERSITY

STUDENT ID NO

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# MULTIMEDIA UNIVERSITY

## FINAL EXAMINATION

TRIMESTER 2, 2019/2020

### **BIE2034 – INTERMEDIATE MACROECONOMICS**

(All sections / Groups)

04 March 2020

(2 Hours)

2.30pm to 4.30pm

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#### INSTRUCTIONS TO STUDENTS

1. This Question paper consists of 6 pages excluding the cover page with 2 sections only.  
**Section A** – Twenty (20) Multiple Choice Questions  
**Section B** – Three (3) Structured Questions
2. Attempt **ALL** questions in both **Sections A and B**. The distribution of the marks for each question is given.
3. Answer **Section A** in the Multiple Choice Questions answer sheet provided and **Section B** in the answer booklet provided.

**SECTION A: MULTIPLE CHOICE QUESTIONS (40 MARKS)**

1. A simple macroeconomic model might explain how an increase in the demand for new housing would lead to a decrease in the rate of unemployment. In such a model, which of these variables is likely to be exogenous?
  - A. The quantity sold of home furnishings.
  - B. The degree of unionization of the construction industry.
  - C. The wage rate for unskilled workers.
  - D. The level of tax revenues.
2. In a model of the saving rate, which of these relationships is most crucial?
  - A. The effect of the saving rate on government spending.
  - B. The effect of government spending on the saving rate.
  - C. The effect of the saving rate on taxes.
  - D. The effect of taxes on the saving rate.
3. If a macroeconomist studying the causes of unemployment suspects that changes in technology might play a role, then this macroeconomist is at which step in the process of developing an economic model?
  - A. Identify the exogenous variables.
  - B. Identify the endogenous variables.
  - C. Compare the model with the data.
  - D. Conduct prediction and policy analysis.
4. Milton Friedman and Edmund Phelps contributed which insight(s) to Phillips curve analysis?
  - A. That firms and workers care about nominal, not real wages
  - B. That wage changes have a one-to-one relationship with changes in expected inflation
  - C. That, in the long run, prices are flexible, so unemployment cannot remain above zero
  - D. All of the above
5. Suppose that inflation is at the target rate and output has fallen substantially below potential output. A central bank with a primary objective of price stability should  
\_\_\_\_\_.
  - A. do nothing, because inflation cannot rise when unemployment is high
  - B. ease monetary policy, to avoid a decrease in the inflation rate
  - C. do nothing, because stabilizing economic activity is not a primary objective
  - D. ease monetary policy, because avoiding high unemployment is more important than avoiding high inflation
6. Many borrowers defaulted on subprime mortgages ultimately disrupting financial markets by August 2007. Which of the following is a likely result of this financial disruption?
  - A. The AD curve likely shifted left which caused a negative output gap.
  - B. The AD curve likely shifted left causing a negative inflation gap.
  - C. The AD curve likely shifted left followed by a downward movement along the MP curve to a lower equilibrium interest rate in the short run.
  - D. All of the above.

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7. If workers push for wages that are beyond what productivity gains can justify \_\_\_\_\_.  
A. a temporary negative supply shock ensues driving up prices  
B. a negative output gap ensues which will lead to higher unemployment if the Federal Reserve does not act  
C. and the Federal Reserve eases monetary policy aimed at increasing aggregate demand to counter the negative supply shock, thereby causing a potential price-wage spiral.  
D. All of the above
8. Suppose you reserve a hotel room in Texas for \$300 per night. When you check out, you are charged only \$285 per night. Assuming that the price of the room in euros had not changed, and that the nominal exchange rate had been 0.8 (euros/\$) when the reservation was made, the new nominal exchange rate is \_\_\_\_\_.  
A. 0.84  
B. 0.76  
C. 0.95  
D. 1.05
9. Under a fixed exchange rate system, if an appreciation in the value of a country's currency develops the monetary authority's \_\_\_\_\_.  
A. will gain international reserves  
B. buy the domestic currency in foreign exchange markets  
C. sell foreign exchange in foreign exchange markets  
D. will lose international reserves
10. The New Keynesian model, is Keynesian in that \_\_\_\_\_.  
A. it assumes wages and prices are sticky.  
B. changes in the money supply are taken to be the single most important influence on business movements.  
C. the velocity of money is a constant.  
D. expectations are assumed to be rational.
11. The real business cycle model begins with the assumption that \_\_\_\_\_.  
A. wages and prices are stick.  
B. wages and prices are completely flexible.  
C. the velocity of money is a constant.  
D. nominal variables are superior to real variables in describing economic activity.
12. The complete wage and price flexibility of the real business cycle framework implies that \_\_\_\_\_.  
A. the velocity of money is a constant  
B. the velocity of money times the money supply is equal to the nominal value of transactions over a given period of time  
C. aggregate output always equals potential output  
D. sustained economic contractions, like the Great Depression, cannot occur in real, historical time

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13. The primary source of shocks to potential output and long-run supply for real business cycle theorists is \_\_\_\_\_.  
A. changes in the money supply  
B. a change in the price of complements  
C. a change in any of the components of aggregate demand  
D. shocks to productivity
14. In the real business cycle model, fluctuations in employment are explained by \_\_\_\_\_.  
A. changes in the composition of household assets  
B. intertemporal substitution as real wages and real interest rates changes  
C. changes in the marginal propensity to consume  
D. the impact of a change in price on quantity demand and quantity supplied in goods markets
15. In the new Keynesian model, an increase in productivity will cause \_\_\_\_\_.  
A. a leftward shift in short-run and long-run aggregate supply  
B. a rightward shift in short-run and long-run aggregate supply  
C. a leftward shift in short-run aggregate supply and rightward shift in long-run aggregate supply  
D. a rightward shift in short-run aggregate supply and a leftward shift in long-run aggregate supply
16. According to real business cycle theory, an increase in financial frictions might lead to \_\_\_\_\_, if \_\_\_\_\_.  
A. a decrease in output; the rise in the credit spread causes a leftward shift of aggregate demand  
B. a decrease in inflation; the disruption of capital markets results in a leftward shift of long-run aggregate supply  
C. a decrease in output; the disruption of capital markets results in a leftward shift of long-run aggregate supply  
D. a decrease in output; a decline in expected output causes a leftward shift of aggregate demand
17. In the new classical model, workers and firms try to keep their real wages and relative prices from falling when \_\_\_\_\_.  
A. income falls  
B. they expect inflation to rise  
C. they expect inflation to fall  
D. they expect aggregate demand to fall
18. Which of the following demonstrates that policymakers cannot know the outcome of their decisions without knowing the public's expectations of them?  
A. Traditional Keynesian theory.  
B. Post Keynesian theory.  
C. Real business cycle theory.  
D. New classical theory.

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19. In the figure above, assume that output is \$10.5 trillion, while potential output is \$12 trillion. Suppose that a combination of fiscal stimulus and recovery of consumer and business confidence shifts the IS and AD curves, as shown in the figure, while monetary policy sets the real interest rate at one percent. If the short-run aggregate supply curve is  $\pi = \frac{4}{3}Y - 13$ , then the resulting values of output and inflation are \_\_\_\_\_.
- A. \$12 trillion & 3 percent
  - B. \$13.5 trillion & 5 percent
  - C. \$9.75 trillion & 0 percent
  - D. \$13.5 trillion & 0 percent
20. The policy ineffectiveness proposition of the new classical model suggests that \_\_\_\_\_.
- A. unanticipated policy has no effect on the business cycle
  - B. anticipated policy can have an effect on the business cycle
  - C. anticipated policy has no effect on the business cycle
  - D. legislative policy initiatives have little effect if the executive branch of government is in the hands of another political party

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**SECTION B: STRUCTURED QUESTIONS (60 MARKS)****QUESTION 1 (20 MARKS)**

- a) According to the economy's self-correcting mechanism, how does the economy return to potential output following a negative demand shock? How is the recovery process different, if the government implements a policy of economic stimulus? (7 marks)
- b) Suppose real output is 14,500, and the demand for real money balances is  $\frac{M^d}{P} = \frac{Y}{4}$ .  
 145i.  
 i) If the equilibrium interest rate is 7 percent, calculate the money supply. (3 marks)  
 ii) If the central bank sets the interest rate at 8 percent, what is the new money supply? (3 marks)
- c) Discuss the effect of Monetary policy (MP), Investment saving (IS), and Aggregate Demand (AD) curves when the inflation rate decreases. (7 marks)

**QUESTION 2 (20 MARKS)**

- (a) Suppose a tax cut that had been anticipated by households and businesses doesn't happen. Interpret a new Keynesian analysis of the consequences of this 'event'. (6 marks)
- (b) As the U.S. economy recovers from the recession of 2007-2009, stubbornly high unemployment is a concern. For each of the three business cycle models, identify the appropriate policy regime. (5 marks)
- (c) Consider an economy in a long-run equilibrium with  $Y = 40$  and  $\pi = 3$ . A demand shock in period one causes output to rise to 45 and inflation rises to 4. Then, the updating of expected inflation to equal 4 causes output in period two to decline to 43.85, and inflation to rise to 4.77. Assuming no further shocks, calculate the values of output and inflation for period three. (5 marks)
- (d) Assume that in a given time frame, the value of transactions in current dollars is \$14 trillion and the money stock amounts to \$400 billion.  
 i) Calculate the transactions velocity of money? (2 marks)  
 ii) What does the transaction variable (T) include? (2 marks)

**QUESTION 3 (20 MARKS)**

- (a) Using the IS-LM model determine the affect does the following have on the shape of the aggregate demand curve:  
 i) A high interest elasticity of investment (3 marks)  
 ii) A low interest elasticity of money demands (3 marks)  
 iii) A small marginal propensity to consume (3 marks)

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- (b) Discuss the difference between new Keynesian and real business cycle models on the ability of inflationary expectations to affect output. (4 marks)
- (c) Analyse insights into the macroeconomic consequences of financial frictions arise from the new Keynesian model. (7 marks)

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